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C O N F I D E N T I A L SECTION 01 OF 02 KYIV 001888

SIPDIS

STATE FOR EUR/UMB AND EEB/OMA

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TAGS: EFIN EREL PREL PGOV UP

SUBJECT: PRESIDENT UNWILLING TO VETO BUDGET-BUSTING BILL

REF: A. KYIV 1835

1B. KYIV 1878

Classified By: Economic Counselor Edward Kaska for Reasons 1.4 (b) and (d)

11. (C) Summary and comment: Putting the next IMF tranche in greater jeopardy, President Yuschenko indicated October 28 that he would not veto a pensions and wages spending bill that would add another \$337 million to the government deficit in 2009 and \$4.7 billion (or about 4% of GDP) in 2010, by NGO estimates. In response, Prime Minister Tymoshenko's government plans to block implementation of the law, possibly through a Constitutional Court challenge. The President has also indicated that he is disinclined to sign a letter of intent with the IMF concerning conditions for disbursement of the fourth tranche of money. The President's unwillingness to work with the Prime Minister and the IMF will undoubtedly put the economy under greater pressure and result in heightened negative sentiment toward the ruling elite in advance of the January presidential elections. End Summary and comment.

Budget-busting Bill Likely to Pass into Law

12. (SBU) While travelling in rural Ukraine, President Yuschenko stated that he "agreed with Parliament" concerning the controversial social spending bill that was passed by the Rada (Ukraine's parliament) on October 20 (Ref A). Yuschenko's unwillingness to veto the Party of Regions-sponsored bill comes despite the negative impact on the budget and IMF's insistence that the bill be vetoed as a condition for disbursement of the fourth tranche under its Stand-by Arrangement with Ukraine (Ref B).

13. (C) Presidential Economic Advisor Shlapak further confirmed that the President was disinclined to sign the letter of intent required by the IMF for additional disbursements, according to IMF resident representative Max Alier. Alier reported that IMF Managing Director Strauss-Kahn is attempting to reach President Yuschenko to discuss the implications of allowing the bill to come into law. G-7 Ambassadors in Kyiv are also seeking a meeting with President Yuschenko to discuss the issue.

14. (C) During a conversation with PolCouns on October 29, former national security advisor Volodymyr Horbulin said that he had given up trying to divine Yuschenko's motives. A veto of the social spending bill was clearly in order from the perspective of national interest. Valeriy Chaliy, Director of the Razumkov Center and former advisor in Yuschenko's Presidential Secretariat, commented that a decision by

Yuschenko not to veto the bill would make it clear that he was driven entirely by political considerations, particularly the desire to undermine Tymoshenko.

Tymoshenko Supporters Looking to Block Implementation

¶ 15. (SBU) Trying to find a way to undo the damage Prime Minister Tymoshenko's government has stated that it will block implementation of the bill should it come into law. For example, Finance Minister Umanskiy said that the bill could not be implemented because it raises spending without making the required amendments to the Rada-approved budget. He also said that the government would search out other legal means to block implementation. The Minister of Labor and Social Policy announced that the government did not have the money to support the spending increase and that the Cabinet of Ministers would file a court case to challenge the constitutionality of the bill if the President signs it into law or chooses not to explicitly veto it.

¶ 16. (C) BYuT MP Valeriy Pysarenko told us that the party is also examining how to prevent the law from being enacted after the President signs it, including the possibility of appealing it to the Constitutional Court based on procedural or other grounds. The Court would then have one month to decide whether to accept the appeal and, if accepted, three more months to rule on the appeal. Politically, Pysarenko does not believe that Yuschenko or Yanukovych would be able to place all the blame on Tymoshenko and told us that, in his

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opinion, Ukrainian voters have stopped differentiating among the three and see them all jointly as the cause of the country's economic problems. He conceded that the worse-case scenario -- an enacted spending bill and a withheld fourth tranche of IMF funding -- would be economically and politically disastrous for the country, but he stressed that such a scenario would not benefit any of the triad.

Opposition: Blocking Implementation Will Backfire

¶ 17. (C) Not unexpectedly, Regions Deputy Faction leader and MP Volodymyr Makeyenko welcomed Yuschenko's support for the social expenditure legislation and said that it showed that there was broad support across political boundaries for raising pensions, wages and welfare payments. He told us that this would only complicate Tymoshenko's ability to block implementing the legislation and that ultimately court appeals to strike down the law would fail. Makeyenko explained that politically Tymoshenko's best option was to find a way to fund the higher social payments because if she challenges the law's legitimacy or refuse to implement it, then she alone will bear the political fallout. He said that telling voters that there was no money in the budget for "modest increases" for Ukraine's poorest would backfire because voters see the "opulent" lifestyle of the country's political leadership.

¶ 18. (C) Makeyenko, who is also the First Deputy Chairman of the Rada budget committee, said that with "proper fiscal management" Ukraine can live without IMF money. He asserted that much of the first three tranches were improperly used for currency speculation, profligate spending, and to finance Tymoshenko's presidential campaign. Makeyenko claimed that the government has still not taken the most basic steps to create an economic crisis plan, including rapid bank recapitalization, direct financial support for major industries, and economic relief for tax payers. Makeyenko asked what had Tymoshenko done with the 10 billion USD already borrowed from the IMF. He predicted that if the IMF does not give Tymoshenko the next tranche to "prop up her

campaign" then Yanukovych could have a chance to win the January presidential election in the first round.

Economic Impact

19. (C) While hard to predict the impact of a delayed fourth IMF tranche, analysts speculate that postponement of the IMF installment would put mounting pressure on PM Tymoshenko to keep government spending under control. This could take the form of wage and pension arrears but also should dampen her promises of additional spending for special interests in the run-up to the election. Analysts have commented that the public would react to the news of an IMF delay by demanding hard currency, which in turn would put downward pressure on the exchange rate and on the banking system. However, an advisor to the Ministry of Finance notes that the banking system is already under water and argues that the impact on the real economy of further banking problems could be minimal since lending is already next to zero.

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